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LINKING GLOBALIZATION, ECONOMIC GROWTH AND POVERTY: IMPACTS OF AGRIBUSINESS STRATEGIES ON SUB-SAHARAN AFRICA

Dave Weatherspoon, Joyce Cacho, and Ralph Christy*

Most of the people in the world are poor, so if we knew the economics of being poor, we would know much of the economics that really matters. Most of the world's poor people earn their living from agriculture, so if we knew the economics of agriculture, we would know much of the economics of the poor. People who are rich find it hard to understand the behavior of poor people. Economists are no exception[o]

T. W. Schultz, Nobel Laureate Lecture, 1979

For most of the last decade, economic prescriptions for many emerging nations have focused predominantly on "getting prices right" by adjusting macroeconomic policy, privatizing state-owned or sponsored enterprises, or opening domestic markets to international trade in agricultural commodities and currencies. The implicit assumption is that structural adjustments will attract foreign capital through the domestic and international private sectors. This new capital would then enable both general market-based solutions and specific firm strategies that contribute to the economic growth and development goals of the nation (Williamson).

More recently, evaluation of the interrelationships among macroeconomic policies, firm strategies, and societal issues has been the source of great debate. While globalization can enhance economic growth, there is little evidence to show that increased private sector investment improves economic development. Analysis of a firm's performance is based on a different analytical construct that pivots on specific profits and long-term growth goals, criteria that are internal to the firm.

A key characteristic of developing economies is the importance of agriculture to their national economies. The Green Revolution fueled rapid growth of agricultural productivity in Asia. Advances in economic development

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The globalization process demands that private sector strategies must now be assessed by their contributions to emerging economies, as well as by company goals.

in Latin America, however, occurred in a tiered policy structure that favored installing value-added, agricultural-based industries and niche products for export markets with convertible foreign currencies. While Asia and Latin America identified mechanisms to stimulate economic development, sub-Saharan Africa (SSA) placed greater emphasis on the political economy at the expense of economic growth and development (Collier and Gunning). Poverty rates in SSA suggest that the focus on political structure left few resources to invest in key rural economic development areas such as persistent poverty, shortage of preventive healthcare, fragmented infrastructure and food security. In SSA countries, the gap between the national economic landscape and that of developed countries has widened, while a similar gap has narrowed for the emerging—and competing—regions of Latin America and Southeast Asia.

This paper analyzes the increased role of the domestic and multinational private sectors in economic development within SSA. The globalization process demands that private sector strategies must now be assessed by their contributions to emerging economies, as well as by company goals.

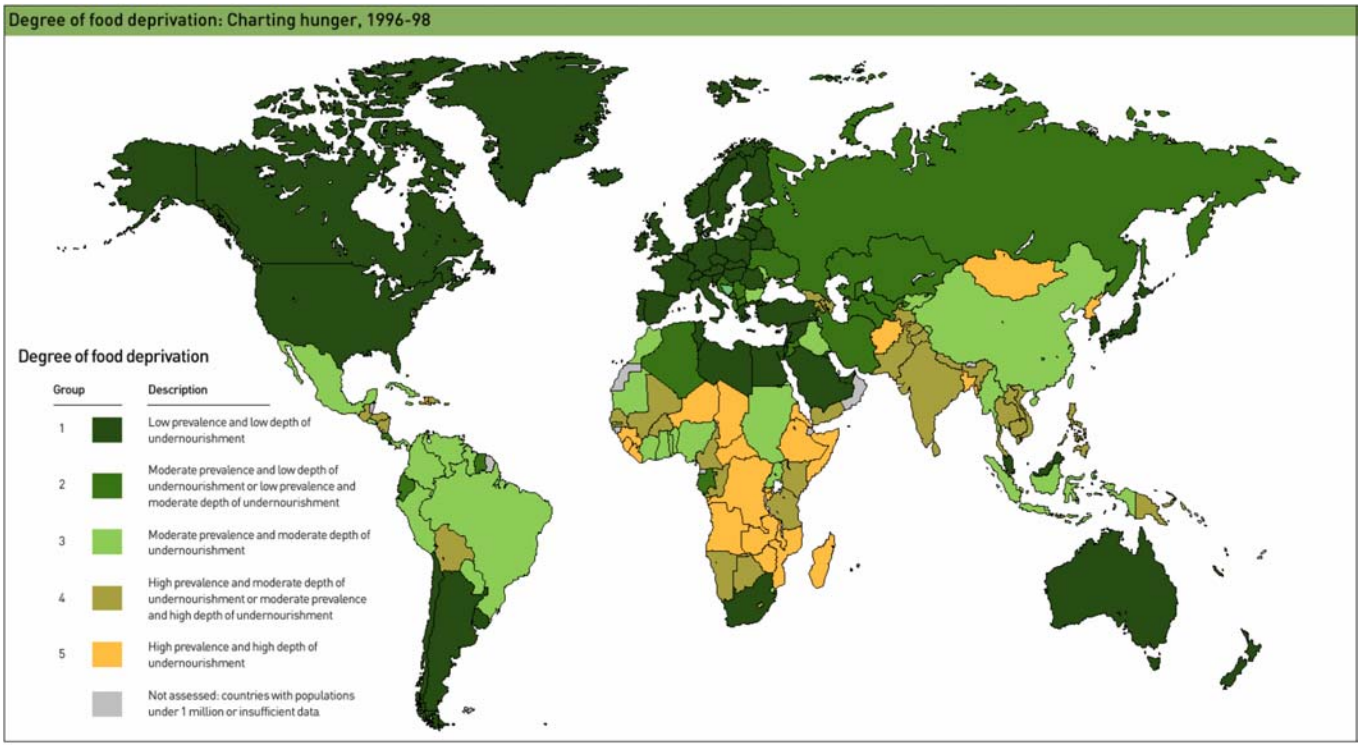

Figure 1. Degree of Food Deprivation: Charting Hunger, 1996-98

AGRIBUSINESS STRATEGIES IN EMERGING ECONOMIES: FORCES AND OUTCOMES

The globalization process is fueled by such forces as the simultaneous opening of financial capital markets and the dismantling of closed trade in agricultural commodities, that raises questions about the links between private sector strategies and the economic welfare of a country. If the globalization process is to be a catalyst for economic growth and development in emerging and developed markets, then understanding these links is crucial. Rapid developments in communication and biological technologies that reduce costs are expanding the range of strategies that agribusiness firms can use to integrate distant rural markets into national economies, and national markets into global economies.

The globalization process is fueled by such forces as the simultaneous opening of financial capital markets and the dismantling of closed trade in agricultural commodities, that raises questions about the links between private sector strategies and the economic welfare of a country.

Globalization inevitably increases competition between industries for financial capital, productive resources, and consumer markets. The unpredictability of agricultural production cycles, however, makes it extremely difficult for food and agribusiness firms to compete against other industries for financing in public markets that demand returns on a quarterly basis. Competitive agribusinesses financed primarily with private capital may invest across borders to mitigate supply risk, expand consumer markets, and diversify products.

In developed markets, agribusinesses may be motivated to internationalize through globalization when there are opportunities to exploit technologies that improve productivity and processing, while at the same time moving to new, growing consumer markets and escaping rising regulatory costs. Expanding industrial agriculture production, in developed markets, may be constrained by government policies about waste management. Growth in developed countries' consumer markets is shaped by price, plus consumer concerns about animal welfare, the seed development process, labor welfare, and the level of chemical inputs.

Also, interest in overseas investments is fueled by a need to establish a country or regional presence to expand the consumer markets necessary to achieve firms' long-term growth targets. Proximity to emerging market consumers is also important to better understand local tastes and preferences and other factors that influence purchasing decisions and food marketing. Although the risk of doing business in the developing world is substantial, the potential for high returns and access to new markets may make it worthwhile to take the risk.

Firms' investment decision not only focuses on short-term profits, but also relies on ensuring that its profitability growth goals are achieved. As firms move offshore to invest in emerging economies, investment decisions not only focus on short-term profits, but also depend on the potential to reach profit growth goals. One approach may be to play a greater role in the development of the overall economy. From the perspective of the developing country, the

increased role of the international private sector focuses on the broader potential to improve social welfare.

Foreign investment, social distributional benefits from introducing new technologies, quality assurance systems and standards, and human capital development are important to the developing country, especially when the country is resource poor. In exchange, developing countries' incomplete or imperfect markets offer investors a higher risk/return ratio, and in the long term, offer consumer markets that support their goals of profitability growth.

Corporate strategies for entering foreign markets vary widely, ranging from indirect exporting to direct investment,[1] and correspond to increasing levels of commitment, risk, control, and profit potential (Figure 2). In addition, expectations by the firm and the developing country about contributions to economic development also differ. Expectations for either indirect or direct exporting strategies are low, principally because these strategies indicate a limited commitment or a short-term view of the developing country market. These low expectations help reconcile the different goals of the firm and the developing country.

Three of the strategies for entry into foreign markets—contracts, joint ventures, and direct foreign investments—present greater challenges when faced with different goals: social welfare for the developing country and profits for the firm. These market entry strategies may affect multiple market participants and provide the opportunity for a differing risk/reward ratio. The profit potential of each entry mode depends on characteristics of the market to which the strategy is applied.

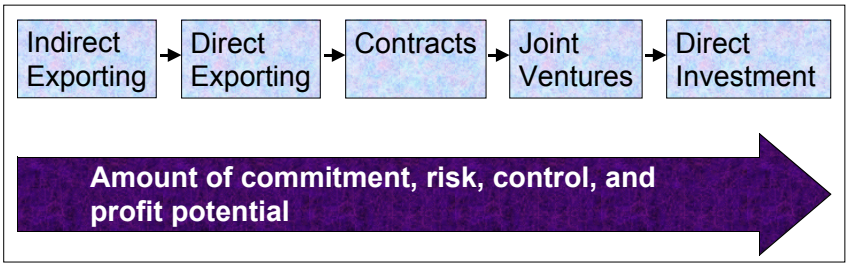

Figure 2. Modes of Entry Into Foreign Markets

We now consider some distributional effects within SSA economies associated with each entry strategy.

[1]Indirect or direct exporting strategies are based on a relationship with a single agent whose role is principally distribution. For indirect exporting, the agent is within the exporters home country, and direct exporting involves an agent in the developing country.

Distributional Effects of Contracts in Emerging Economies—Lessons from Africa

The use of formal contract arrangements among input suppliers, farmers, and food processing firms began in the 1930s in America and gained prominence in industrialized nations by the 1960s, at which time the concept of agribusiness was emerging. Contract farming was introduced in Africa, Latin America, and Asia in the form of "out-grower schemes" during the 1980s, when farmers were contracted to grow a crop that was marketed through a multinational company (Grosch). In many emerging nations, especially in SSA, contracts are usually unwritten agreements between export or processing firms and smallholder farms, cooperatives, or producer organizations. The use of contracts, more than other strategies available to the firm, is more closely related to the industrialization of the agricultural sector.

What is the rationale for contract farming in developing economies? Contract coordination in Africa, for example, is believed to be a type of institutional innovation that helps farmers by providing new technology, ready markets, secured inputs and prices, and increased cash incomes. Further, contract coordination offers a mechanism that ensures "self-sustained" development. Governments can benefit through foreign exchange earnings and food security improves if the contracted commodity is a food crop. Private firms are assured in advance of delivery of specific products at predictable times, thus reducing reliance on unpredictable spot markets.

Critics of contract coordination believe that it increases local socioeconomic differences because private firms prefer to work with "progressive" farmers and dependency of the agricultural community on imported inputs. Contracting introduces new export crops that often shifts land away from food crops and allocates resources to production of urban or export-oriented crops, thereby disrupting local domestic production patterns. Farmers lose autonomy because contracting firms control most production decisions and may skew risk and profit sharing in their favor. The contracting firm benefits by achieving greater control over a crop than would have been possible under spot markets, yet they avoid costs and risks associated with investments in production. Farmers then face a monopsonist who is able to dictate prices and exploit quality standards to suit his objectives. Specialization and use of inputs provided by the contracting firm traps farmers in a dependent relationship where they ultimately lose their ability to participate in highly competitive and unstable markets (Glover).

Some form of contract farming (out-grower schemes) is used in all countries in SSA. The most notable efforts in a growing body of literature on contract farming in Africa are from the Institute for Development Anthropology (IDA) for the Africa Bureau of the United States Agency for International Development. In the mid 1980s, IDA published a number of comparative studies based on surveys carried out in Kenya, Gambia, and Senegal (De Treville, Rassas, Jaffee). Although contract farming schemes are typically unique, several general conclusions can be drawn from these empirical studies.

Jaffee and Jaffee and Morton found that contracts were associated with higher cash incomes for the participating households, created employment, and introduced new technologies that were transferable to crops that were not grown under contracts. In addition, income increased over the years and women farmers had more control over handling and allocation of household finances. Jaffee concluded that the success of a scheme depends on the ability of the firm to improve farmer productivity and the ability to control leakage of money, inputs, and products. Because enforcement of contracts is not feasible, firms must rely more on trust, hence a good relationship with farmers and local leaders became important. The research of Kimenye supports the positive income effect of contract farming with smallholders. He found that on average contract farmers received 37% higher yields and 80% higher net margins than non-contract growers, and that farmers who used contracts had more access to technical advice and market information.

Institutional issues must be reexamined to restructure agreements between small-scale farmers and agribusiness firms, strengthen contract law, and improve ways to enforce contracts.

Despite the overwhelming positive results from these empirical studies, reports of contract farming failures are numerous due to "breach of contract" and/or "bad faith dealing" on the part of farmers and agribusiness firms. Because institutional factors associated with farming play an important part in determining economic outcome, theoretically misallocation of resources can occur on farms where owners employ contracts to vertically integrate with input or processing firms. For example, the changing pattern of fully independent farm owners to a vertically integrated system (via contracts) alters property rights in ways that both positively and negatively affect the economic performance of the agricultural sector.

Beckford argues that major distortions in resource use arise from the inherent conflict between the interests of the principal and those of the agent. This conflict arises because each party uses inputs that are owned by the other. In reality, the outcomes vary depending on the terms of trade between small-scale farmers and contracting firms. With the recent increase in contract farming, little qualitative or quantitative information is known about the relative bargaining power between contracting parties and the resulting distributional effects. There is insufficient information on the long-term effects of contract agriculture on productivity, food prices, food security, and the environment in emerging nations. Institutional issues must be reexamined to restructure agreements between small-scale farmers and agribusiness firms, strengthen contract law, and improve ways to enforce contracts.

Distributional Effects of Joint Ventures

Joint ventures are an alternative approach to enter emerging markets. Joint ventures (JV) are investments between two or more firms, based on exchange of financial capital and/or stock equity in horizontal or vertical markets. Approximately 20 years ago, firms throughout industry chose mergers and acquisitions over employing financial capital to build new facilities to expand business. The opportunity to capture additional value from synergies found in complementary assets, beyond economies of size and strengthening

the balance sheet, is a strong motivation for JVs. Achieving synergies between JV firms can be a formidable challenge. The cost of missing the JV synergy mark is magnified by the expense of disentangling a failed JV attempt.

Joint ventures have occurred predominantly between firms in developed countries. In the strictest definition, preference for JVs has ebbed in developed countries because strategic alliances are employed more frequently. Benefits can be derived by acting as a single firm, while at the same time mitigating risk by establishing a formal understanding rather than exchanging financial instruments.

Examples of food or agribusiness JVs with firms in SSA are almost absent. In the literature, this topic is dominated by examples from China and a few examples from Eastern Europe. In SSA, countries with diverse vestiges of political systems, institutional frameworks, labor force readiness, and economic instability all raise the transaction costs of JV investing relative to competing emerging markets. Nonetheless, JVs have great potential to catalyze key domestic markets, which in turn could improve socioeconomic conditions.

The JV strategy may be the most desirable option for domestic and foreign firms entering emerging markets. In forming a JV, local and foreign partners define their commitment to a joint profit objective. The capital and knowledge of the host environment that the local partner brings to the JV, including the social welfare challenges, are factors in the investment decisions made by the foreign firm.

Host environment "knowledge" may include the local distribution network, consumer tastes and preferences, as well as cultural factors that influence labor force productivity and food purchasing decisions. Beyond the foreign firm's financial capital, their management and technology systems make investing with an international JV partner attractive to local emerging-market investors. Management and technology systems introduce production processes that increase the probability of improved productivity, product quality, and flow consistency. Success of a new JV—defined as achieving a profit within the shortest time possible while expanding the foreign firm's consumer market—hinges on a business development strategy that views non-financial contributions from the local and foreign firms as assets.

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JV investments have historically been a notable opportunity to exploit SSA and the overall environment of emerging markets. The role of JV local partners was limited to reducing the transaction costs to extract resources, without interest in fostering a longer-term relationship with the local market. This "feigned" commitment provided limited probability for financial capital, or knowledge multiplier effects.

Expanding consumer markets from national to international requires a corporate strategy that considers information about host country market forces—demography, social and cultural characteristics, economic factors, technology base, legal and regulatory framework, and competing local products.

This information is usually not readily available to the public, and varies in quality on a national or regional basis.

The increased importance of local consumer markets that has accompanied globalization also raises the bargaining power of local parties that may own underperforming assets. Injecting financial capital and management and technology systems that improve productivity may be the catalysts for these assets to reach their full potential. In a JV, a well-defined legal framework is important to use knowledge assets from the local and foreign investors to produce profits and social welfare benefits.

When JVs are chosen as the mechanism to enter emerging markets, implications for risk management are heightened. For SSA firms and international investors, JVs offer the opportunity to reduce the cost of financial capital by expanding the choices and improving the bargaining power of the JV with financial institutions. Further, JVs offer the benefit of diversifying the product portfolio, which is especially valuable when there is intra-company trade between emerging and developed market products. Conceptually, these benefits of risk management establish that the JV has notable profit potential.

An alternative view of the JV mechanism focuses on the challenges of melding two different business and social cultures, and in many instances, differing value structures. Significant differences in capacity and economic integration between rural areas in emerging and developed markets can make it difficult to harmonize expectations of productivity. Investing the time to understand these differences is important if the JV is to capture benefits from risk management and synergies, as well as establish a solid foundation to improve productivity. The JV improves its asset performance through its socially responsible approach as a component of the business decision to pursue higher risk/reward ratios offered by investing in SSA.

Distributional Impacts of Foreign Direct Investment

Rather than exporting, some food and agribusiness firms are choosing to serve their international clientele by establishing foreign production subsidiaries that they own completely. Simultaneously, most nations are actively recruiting firms by offering incentives to locate in their country. The combination of opening economies, incentives, and firms seeking international markets have contributed to the dramatic increase in foreign direct investment (FDI) in emerging markets. FDI in emerging markets increased from approximately U.S. $10 billion to more than U.S. $180 billion from 1980 to 1998 (United Nations Conference on Trade and Development [(UNCTAD)/2000]). Part of this increase can be explained by the higher average returns in emerging markets than industrialized countries, e.g., 15.3% for emerging markets versus 12.5% for all countries (UNCTAD/1998).

Regional rates of return differ greatly (Africa, 36.9%; Asia-Pacific, 19.3%; Latin America and Caribbean, 12.8%), but in their FDI decisions, firms

bypassed the highest rate of return—Africa (UNCTAD/1998). Although total foreign investment in Africa rose from U.S. $1 billion to U.S. $8 billion from 1980 to 1998, FDI in the Asia-Pacific and Latin America and Caribbean regions was far greater. Revolutionary advances in communications and biotechnology have strong implications for the ability of SSA to curb increases in poverty and malnutrition rates. Making effective use of those technologies will require governments to invest in infrastructure and other public goods to leverage FDI. Public policy is a key factor in effectively reducing poverty through investments.

The spectrum of entry strategies into a country's market can yield both positive and negative distributional effects.

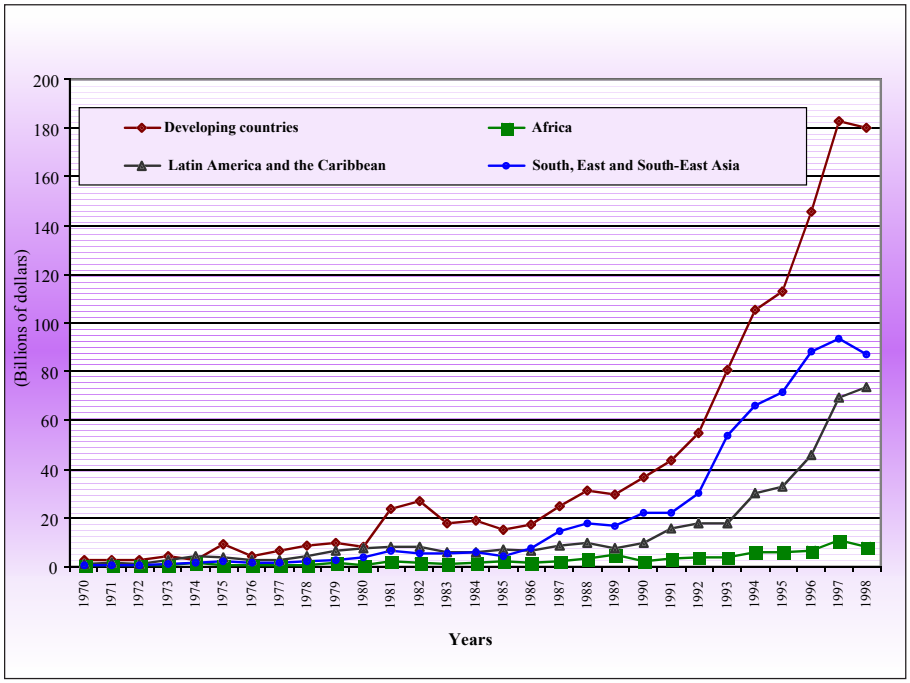

Figure 3. FDI Flows into Africa, Developing Countries and Selected Regions, 1970-1998

Modernization and dependency theories suggest that initially FDI increases income inequality within emerging countries (Tsai). The modernization theory stresses that sufficient output must be first produced before it can be redistributed, hence the presence of investment is more important than its origin. The path of the income effect of capital investment, regardless of the source, can be characterized by Kuznet's inverted-U curve. Dependency theorists state that FDI is utilized by the local labor elites in emerging markets to create an inter-country coalition to maximize their own interests. In this scenario, persistent income inequality is possible through this alliance of the state, labor elite, and foreign capitalists. These observations emphasize the need for a national strategy to leverage FDI to ensure positive results.

The spectrum of entry strategies into a country's market can yield both positive and negative distributional effects. A major positive distributional effect of FDI is that consumers usually have greater access to consistent quality and capital-intensive products, at a lower price. The country also benefits from the infusion of permanent physical capital, which is not always the case for JVs or contracts. On the other hand, firms that acquire or directly invest in SSA may negatively influence domestic competition and smallholders. This crowding-out effect occurs in many ways, but the most common is that foreign firms usually introduce grades and standards to the market. These new standards systematically reduce the market size for domestic firms and smallholders. Global firms source little domestic talent for their foreign operations, hence, the multiplier effect is somewhat reduced (Tsai). Few rural firms and smallholders are able to participate in the new markets, which leads to this question: How can rural firms and producers be engaged and enhanced as a result of an increase in foreign capital?

The benefits of FDI can be marginalized and costs minimized depending on government policy and the overall investment environment. Positive results are possible if the government has a strategic plan to leverage foreign investment and domestic resources, including human resources, to maximize economic growth and reduce income inequality. A country without a strategic plan is in essence relying on foreign capital to create an enabling environment for everyone in the country. This approach to policymaking is insufficient and misguided. The next section will examine various strategies for governments and private firms to consider when promoting economic growth and development through foreign investment.

Negotiating an Enabling Environment—the Role of the Public Sector

In the past, many SSA governments have made poor economic decisions that have exploded into dire poverty and poor health conditions throughout the region. FDI targeted at emerging nations has not been directed at SSA. Additionally, international aid to SSA has diminished within the last decade—net official development assistance and official aid declined from U.S. $17.5 billion to U.S. $14.2 billion from 1993 to 1998 (World Bank). The lack of FDI, diminished overseas development assistance, and the uncertainty associated with globalization combine to place SSA economies in a challenging situation. Globalization may provide the on-ramp for these economies or further widen the gap between North and South.

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Creating an enabling environment for a healthy private sector is possible if a nation is committed to achieving a *competitive* advantage (Porter). Specifically, it is vital for SSA nations to evaluate regional competitive advantages and target those industries along with some of the high technology industries. In selecting industries, governments should factor in the market difficulties experienced by smallholders and small firms in the various growth strategies especially since 70-80% of the population falls in this category.

Success depends on sufficient domestic consumption of these goods followed by a strong export market.

Assuming that value-added agriculture is a targeted industry, governments can improve the competitive nature of the sector through several actions. Education is primary when upgrading production factors, along with transparent and seamless market information and infrastructure investments. Strategic partnerships with industry on these factors, along with creating domestic consumption, are vital.

SSA governments realize that agricultural research and development (R&D) firms will not locate in the region. To reach the next level of value-added products, scarce resources will need to be committed to publicly-sponsored R&D activity. In agriculture, this investment means that partnerships with multinational firms must be negotiated such that the innovations can be re-engineered or adapted legally to regional crops, animals, or machines. This strategy is a slow process, but over time, innovative activities attract additional innovative firms, and eventually a sizeable talented pool of researchers will generate new markets within and outside the region.

In today's globalization era, however, agribusiness firms compete for financial capital against firms in industries that have historically looked beyond industry-specific policies for opportunities.

Agricultural, trade, and development assistance policies contribute to the investment behavior of agribusiness firms. In today's globalization era, however, agribusiness firms compete for financial capital against firms in industries that have historically looked beyond industry-specific policies for opportunities. The expanded public policy set includes corporate tax policies. Tax expenses—the amount and payment timing—can be instrumental in determining the value of any investment. Desai and Hines shows that tax policy, targeting foreign tax credits, for example, can determine the investment value and entry mode of cross-border investments. The lower a country's tax rates, the more likely that U.S. multinational investors will use a financial capital structure that is higher in debt and pay more royalties to their U.S. parent firm. This capital structure focuses on short-term, extractive opportunities in high GDP growth, high R&D intensity countries—characteristics not present in SSA emerging market countries.

A fine line separates fostering growth and creating white elephants. The current economic predicament of SSA countries is unprecedented and hardly fits any modern models of development. In the past, SSA public policy was heavily involved in private industry and has fostered insulated, dependent, and non-competitive firms. This time around, governments can encourage domestic rivalry to influence sophisticated supply and demand.

In addition to national policy, worldwide leadership is crucial for these governments to negotiate future trade terms. Worldwide reduction of tariff barriers has dramatically increased world trade in fresh and processed agricultural commodities. Today, producers and processors around the world are in direct competition with one another. The globalization of food and agribusiness has begun to shift the standard setting and enforcement processes to international agencies such as the World Trade Organization (WTO), the

International Organisation for Standardisation (ISO) and the Organisation of Economic Cooperation and Development (OECD). Harmonizing standards to transcend national borders will be a central feature of the food and agriculture system for the foreseeable future. SSA should focus on efforts to determine the details of these agreements and how they can help the region to improve conditions for all producers—regardless of their size—and increase exports.

Private Sector Initiatives in Emerging Markets

Profits depend principally on using assets efficiently and reducing costs. Increasing profitability growth depends on strategic investments—not only for raw material supplies, but also for consumer markets. In the earlier era of closed markets, profitability growth strategies focused on price in the firm's domestic market, and developing export markets in emerging markets using government economic development assistance programs.

Along with a profitability strategy, linked to the opening of financial and commodity markets (the globalization process), firms must embrace a long-term view of emerging markets. By investing in underperforming assets in emerging markets, firms need to acknowledge that in the shorter-term, the investment contributes to the profitability growth goal by improving the social welfare and purchasing power of future consumers. In the longer term, the investment assets will contribute to measurable future profits. By leveraging the investing firm's technology and knowhow, that qualitative value and contribution, can catalyze realizing measurable profits in SSA markets, as well as reduce rural urban migration and persistent hunger, and increase the availability of preventative medical care.

By investing in under–performing assets in emerging markets, firms need to acknowledge that in the shorter-term, the investment contributes to the profitability growth goal by improving the social welfare and purchasing power of future consumers.

Firms based in developed markets have the skills and technology that can reduce the cumbersome administrative processes in emerging markets. For example, in many SSA countries, information management for efficient, low-cost credit administration is in great demand. This is a notable difference from developed markets where computer-based data and process management is commonplace. With limited training for local staff and adaptation of hardware and software systems, the basics of agribusiness management can be established.

Financing insured by a group has proven to be an effective substitute for the collateral of physical assets used in developed markets. The mutual trust and accountability characteristics of group financing are associated with 98% loan repayment at acceptable market interest rates. The Grameen Bank in Bangladesh, where small loans (U.S. $20) are managed and insured, typically by groups of five women, is the most notable example. This type of "micro-credit" financing is appropriate for SSA's rural, agriculture-based environment. A huge obstacle confronting grass roots/rural organizations, especially in debt-ridden SSA, is the availability of start-up capital. Developed market, private investors can more readily provide the needed initial capital as an investment to upgrade the quality of productive resources. The effectiveness of employing

this mechanism to ensure improvements in quality and quantity of agricultural products and the social welfare in the host country pivots on understanding the relationship between gender and crop production.

Focusing on private/public partnerships is key to capturing value that multinational agribusinesses need to sustain profitability growth. As SSA governments work to meet the challenge of public debt that increases as their exchange rates decline, private partners can offer technical and management training—a principal catalyst to improving the rate of economic growth and development.

Sustainable profitability depends on increasing the number of middle class consumers. The benefits from private firms that partner with state or federal governments to establish schools, roads, or wireless telephone communication are linked to the longer-term goal of increasing consumer purchasing power—which is considered a "positive" by investors and governments.

CONCLUSIONS

The globalization process has the potential to benefit the economic development of Sub-Saharan Africa. It has fused the theoretical stages of economic development, and raised the premium on the traditional, sequential approach. SSA governments are investing in the necessary components to foster economic stability and increase the middle-class, including infrastructure, opening telecommunication markets, and internet-based distance learning programs. Competition for capital, driven by globalization, is pushing private sector agribusiness to seek opportunities to capture higher returns in the longrun.

This approach encourages a shift in strategies for internationalizing. Rather than trade in final consumer goods, multinationals are leveraging—either by production contracts, joint ventures, or wholly-owned companies—their technical expertise to introduce production efficiencies while, at the same time, learning about the tastes and preferences of the soon-to-be middle class in SSA. It is agricultural trade and macro-economic public policies, along with corporate tax policy and firms' new interest in translating soft assets or qualitative factors into profits—all working simultaneously—that defines the opportunity to include SSA as beneficiaries of the globalization process.

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